

Company Law Review response

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Sustainable
Development Commission

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RE: COMPANY LAW REVIEW RESPONSE

You may recall at our recent meeting that I mentioned that I would be putting in a submission on behalf of the Sustainable Development Commission relating to the Company Law Review. We discussed this at our plenary on September 26th and have the following comments to offer.

Firstly, we warmly welcome the Government's commitment to modernise company law, and in particular the proposed moves to make companies' activities more accountable and transparent.

As you know, the Sustainable Development Commission is an advisory, non-departmental public body, formally sponsored by the Cabinet Office, and reporting to the Prime Minister, the First Minister in Scotland, First Secretary in Wales and First and Deputy First Minister in Northern Ireland. The Commission's main role is to advocate sustainable development across all sectors in the UK, review progress towards it, and build consensus on the actions needed if further progress is to be achieved. The Commission comprises of a range of senior representatives from the public, voluntary, academic and business sectors, and these comments represent our unanimous opinion.

We view the business community as having a critical role in progressing towards sustainable development, and consider this review of company law as an exciting opportunity to encourage companies to develop a longer-term perspective of their performance and to assess the wider impacts of their activities.

The emphasis on increased transparency is essential in ensuring that companies move forward on the path to sustainable development. We agree that *'timely, effective access to high quality information'* is fundamental for effective governance (para. 3.28 p.48). We also welcome your recognition that 'stakeholders' other than the shareholders (i.e. employees, trading partners or wider the community) have a legitimate interest in a company's activities (para. 3.29 p.48).

In principle, we feel that the Operating and Financial Review (OFR) will provide a valuable statutory framework for reporting for larger private companies or public companies, and that this will allow greater recognition of qualitative assets or non-financial performance. Furthermore, making the OFR a requirement rather than a voluntary compliance, as was the case with the current ASB guidance, is a very welcome step in the right direction.

However, we are concerned that the requirements set out in the OFR do not go far enough towards ensuring this. From the sustainable development perspective, we are very disappointed by the recommendation to government to make two key sections of the OFR discretionary rather than mandatory:

- ***Section v) ‘Policies and performance on environmental, community, social, ethical and reputational issues including compliance with relevant laws and regulations’; and***
- ***Section vi) ‘An account of the company’s key relationships, with employees, customers, suppliers and others upon which its success depends’ (including compliance with international labour conventions and anti-discrimination laws).***
(p.184)

The rationale that these should not be mandatory requirements because they are not universal materialities (i.e. applicable to the performance of all large companies) is flawed and inadequate. When discussing a company’s performance on human rights, discrimination or the environmental impacts of the company’s activities and their compliance with environmental laws and regulation, can anyone really suppose that these issues are not material to the longer-term performance and wider accountability of all large companies?

Although we accept that for some sectors and types of companies the environmental or ethical impacts may be more recognisable and visible, all large companies should take account of their wider obligations if they are to be successful in the longer-term and accountable to a range of stakeholders. Many large companies already have sophisticated reporting systems that will take into consideration non-financial or more qualitative performance measures and will be willing to disclose this information.

However, we are very concerned that because of the vague and subjective requirements for the OFR to report on environmental, social, ethnic and anti-discriminatory issues, companies may only be forthcoming in disclosing information on areas where they are performing well and not on those where they are performing less well or even failing to comply with regulation. For example, whilst a company may be forthcoming in reporting on its work on community projects, it may be less willing to report on its performance in meeting environmental regulations. Consequently, there is a concern that these reports will present a partial and inadequate view.

Although section three of the OFR, which refers to the ‘Dynamics of the business’ including risks, such as ‘health and safety’ and ‘environmental costs’, is now mandatory, we feel that this does not give significant enough weighting to environmental, social and ethic issues or provide a positive approach to addressing them.

As I’ve said, and indeed made very clear at our meeting on September 13th, we welcome this Review, and especially the statutory footing for company reporting which includes a series of qualitative performance measures (such as environmental impacts, social responsibility and ethical performance). We also agree that small companies should not be subject to such accountability, although positive and incentivising measures to encourage them to consider their environmental, social and ethical performance should definitely be considered.

But where this Review misses the opportunity to contribute to the Government's sustainable development agenda is in not making this a statutory requirement for all large companies and public companies. We would therefore urge you to reconsider this recommendation when drafting the legislation to implement the review, and change the disclosure on environmental, social and ethical performance from a discretionary duty on the part of the relevant Director to a mandatory requirement of the CEO.

Greater guidance also needs to be provided on the specific form of environmental, social and ethical information that should be presented in the OFR. There already exists commitment and consensus on such guidance. For example, in 2000 the Global Reporting Initiative, convened by the Coalition for Environmentally Responsible Economics (CERES) in partnership with the United Nations Environment Programme (UNEP), released a set of Sustainability Reporting Guidelines.

If the decision remains that disclosure on environmental, social and ethical performance will only be required '*to the extent that it is material*' to the individual company, then there should at least be a requirement for companies to state why reporting on these measures is not material. Failure to do so should result in a further investigation.

As I mentioned at our meeting, the Commission would be willing to engage in further discussion on any of the points we have raised above. In particular, we would be keen to contribute to additional discussions on the detail of the information that should be contained within the sections on environmental, social, ethical and anti-discrimination reporting and if necessary the Commission will itself commission work on how legislation or guidelines might be drafted.

We do not concur with the view of the Review Panel that it is in part the impossibility of drafting legislation or guidelines in this area that swings the balance against a mandatory approach. At the very least, it should be tried before rejecting the mandatory (with all its other significant benefits) and we would be more than happy to play some part in that process.

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